

This letter discusses application of the Service Occupation Tax to maintenance agreements. See 86 Ill. Adm. Code 140.301. (This is a GIL.)

August 10, 2006

Dear Xxxxx:

This letter is in response to your letter dated February 23, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I have been asked to assist in the financial setup of a new business called ABC which will first transact business in 2006. The business will offer maintenance contracts to both taxable and tax-exempt entities covering equipment such as copiers, fax machines, computers, printers, and telephone systems. Our customers will have the option to use a preferred repair vendor or a repair vendor of choice. If the customer uses a preferred repair vendor, the vendor invoice will come directly to ABC and we will pay the repair vendor directly. If the customer uses a repair vendor that is not on our preferred list, the vendor invoice will be paid by the customer and ABC will reimburse the customer. I have several questions relating to the taxability of these transactions:

1. Does ABC need to charge sales tax on this type of maintenance contract if sold to a taxable entity?
2. If the answer to #1 is yes, when equipment is repaired at the taxable entity by a preferred vendor the invoice will come directly to ABC and we will pay the vendor directly. Are the repair parts and/or labor taxable? If not, and the vendor bills tax, may we provide the vendor with a resale certificate since we charged tax on the contract?
3. If the answer to #1 is yes, when equipment is repaired at the taxable entity by a vendor of choice the invoice will go to our customer for payment and ABC will

reimburse the customer. Are the repair parts and/or labor taxable? If not, and the vendor bills tax, may the customer provide the vendor with a resale certificate since tax was charged on the contract?

4. If the answer to #1 is no, when equipment is repaired at the taxable entity by a preferred vendor the invoice will come directly to ABC and we will pay the vendor directly. Are the repair parts and/or labor taxable?
5. If the answer to #1 is no, when equipment is repaired at the taxable entity by a vendor of choice the invoice will go to our customer for payment and ABC will reimburse the customer. Are the repair parts and/or labor taxable?
6. Does ABC need to charge sales tax on this type of maintenance contract if sold to a tax-exempt entity?
7. If the answer to #6 is yes, when equipment is repaired at the tax-exempt entity by a preferred vendor the invoice will come directly to ABC and we will pay the vendor directly. Are the repair parts and/or labor taxable? If not, and the vendor bills tax, may we provide the vendor with a resale certificate since we charged tax on the contract?
8. If the answer to #6 is yes, when equipment is repaired at the tax-exempt entity by a vendor of choice the invoice will go to our customer for payment and ABC will reimburse the customer. Are the repair parts and/or labor taxable? If not, and the vendor bills tax, may the customer provide the vendor with a resale certificate since tax was charged on the contract?
9. If the answer to #6 is no, when equipment is repaired at the tax-exempt entity by a preferred vendor the invoice will come directly to ABC and we will pay the vendor directly. Are the repair parts and/or labor taxable? If not, and the vendor bills tax, may we provide the vendor with the tax-exempt entities exemption certificate since we are merely acting as a third party payer for services provided to the tax-exempt entity?
10. If the answer to #6 is no, when equipment is repaired at the tax-exempt entity by a vendor of choice the invoice will go to our customer for payment and ABC will reimburse the customer. Are the repair parts and/ or labor taxable?
11. We intend to register ABC in your state with the Secretary of State. We also intend to register for a Sales and Use Tax Certificate if applicable. Are there any other State departments that we need to register with to conduct this type of business?

Please forward responses to:

NAME/ADDRESS

Thank you in advance for your cooperation.

DEPARTMENT'S RESPONSE:

The taxability of maintenance agreements depends upon if charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance contracts are sold separately from tangible personal property, sales of the contracts are not taxable transactions. However, when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3).

Purchasers of separate maintenance agreements are not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance contract. Where a business provides repair or maintenance services that are accompanied with the transfer of tangible personal property, such transactions are generally subject to tax liability under the Service Occupation Tax Act. See 86 Ill. Adm. Code 140.140(l).

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident of their sales of service. Servicemen incur either Service Occupation Tax (SOT) liability or Use Tax liability in these transactions. The tax consequences depend upon the method used to calculate the liability. Servicemen may calculate their tax base in one of four ways: 1. Separately stated selling price; 2. 50% of serviceman's entire bill; 3. SOT on his cost price if he is a registered de minimis serviceman; or, 4. Use Tax on his cost price if he is an unregistered de minimis serviceman that is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Please see 86 Ill. Adm. Code 140.101, the Basis and Rate of the Service Occupation Tax.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. A serviceman who incurs Service Occupation Tax on his selling price should provide Certificates of Resale to his suppliers when purchasing tangible personal property that will be transferred to service customers. Please refer to 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

De minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act may use the final method of determining tax liability. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108. These de minimis servicemen do not provide Certificates of Resale to suppliers.

Your letter indicates that your client may use a third party provider for the performance of certain services. Please be informed that firms who do service work for customers of another business are sometimes secondary servicemen in multi-service situations. Multi-service situations exist where a primary serviceman subcontracts work to a secondary serviceman. The taxability of a primary serviceman in a multi-service situation is set out in 86 Ill. Adm. Code 140.145.

Organizations that qualify as exclusively religious, charitable, or educational can apply to the Illinois Department of Revenue to obtain tax exemption identification numbers ("E" numbers). These numbers establish that the Department recognizes said organizations as exempt from incurring Use Tax when purchasing tangible personal property in furtherance of their organizational purposes. The organization can also use their E number to document exemption from Service Use Tax in a service transaction where they receive tangible personal property as an incident of a purchase of service from a serviceman. See 86 Ill. Adm. Code 160.101. Unregistered de minimis servicemen may use their service customer's exempt status to purchase tangible personal property that is to be transferred to an exempt service customer. See 140.108(a)(2)(A).

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess
Associate Counsel

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